Fact Sheet

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EXPORT SUBSIDIES: A DISTORTION TO FREE TRADE IN AGRICULTURE

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There is "no economic justification" for the continued use of export subsidies, says Timothy Galvin, who oversees the administration of programs to foster exports of U.S. agricultural, fish, and forestry products. "By removing subsidized exports," Galvin maintains, "world prices should increase, and farmers, particularly in the EU, will not be artificially encouraged to overproduce products that they cannot grow competitively."

Galvin also urges further disciplines on the use of export taxes so that, when used, they are for legitimate revenue purposes and not as a competitive export tool or to deny commodities to food importing countries.

Export subsidies are generally considered one of the most distorting trade tools used by governments to interfere with commercial markets. Export subsidies allow a government to determine the level and direction of trade solely on the basis of government subsidies, lowering world prices and denying sales for other, more competitive exporters. Not only are export subsidies unfair commercial tools, but, by encouraging surplus production, they encourage adverse environmental practices, waste government budgets, and may delay restructuring and reform of domestic industries. Substantial progress toward eliminating export subsidies will be a critical element of the World Trade Organization (WTO) negotiations scheduled to begin at the end of this year.

The Situation Today

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Under the Uruguay Round Agreement, countries agreed to strictly limit the use of export subsidies. First, products that had not benefitted from export subsidies in the past were banned from receiving them in the future. Second, where countries had provided export subsidies in the past, their future use was capped and gradually reduced over 6 to 10 years. (Developed countries were required to cut their spending on export subsidies by 36 percent over six years while also reducing subsidized export quantities by at least 21 percent on a commodity-specific basis. Developing countries have until 2004 to cut spending by 24 percent and subsidized quantities by 14 percent.) Third, countries agreed not to create new schemes that serve as disguised subsidies to get around the product-specific limits. Finally, countries recognized that export credit and food aid programs were different and exempted them from the new budget and quantity limits, although there was agreement to negotiate disciplines on export credit programs to ensure that they do not undermine WTO commitments.

Today, the European Union (EU) is the primary export subsidizer -- accounting for nearly 85 percent of the world total. Nearly all other countries agreed in the last round of negotiations not to use or to have only limited recourse to use export subsidies. EU farmers, responding to domestic prices that are often twice the world price, produce more products than can be consumed in Europe, but at such high prices that they can be sold abroad only with generous subsidies. These subsidies force other competitors out of the market and discourage production in countries with comparative advantage.

If the EU's extravagant domestic subsidies are the root cause of export subsidies, they are also putting serious pressure on the whole EU system. The need to impose budgetary discipline on EU farm programs (annual cost, about $46 billion) is becoming increasingly evident, even in Europe, and the EU's goal of expanding its membership to new countries is putting pressure on it to bring its farm programs into line with other countries, which will help reduce its need to rely on export subsidies in the future.

Areas for Resolution

The upcoming negotiations should continue the work begun in the Uruguay Round and eliminate existing export subsidies. There is no economic justification for their continued use. By removing subsidized exports, world prices should increase, and farmers, particularly in the EU, will not be artificially encouraged to overproduce products that they cannot grow competitively.

In addition to eliminating the export subsidies, countries should examine the rules defining export subsidies to ensure that countries do not resort to other policy tools that might allow governments to distort markets. Specifically, WTO members should look closely at curbing agricultural state trading export monopolies that can exert undue market power or dispose of surplus commodities on a non-market basis. A recent WTO victory by the United States and New Zealand over Canada's special-class system of dairy exports shows that the existing rules against circumvention are effective but must be enforced.

Export credit and food aid programs were addressed in the Uruguay Round agreement in recognition of the fact that these tools could be disguised as export subsidies. These policies may again be on the agenda when the WTO negotiations commence. It will be important to ensure that the world's needy continue to have access to imported products, even when financial turmoil roils world markets and limits the ability of developing countries to meet their food and fiber needs.

Certain large exporting nations -- primarily within the EU -- have used export taxes as a supply management tool by intervening in the market to restrict exports when domestic stocks are low. These measures can wreak havoc in international markets, exacerbating price swings and reducing the confidence of net-food-importing countries to abandon trade barriers and rely on the international market to provide food security. Similarly, some exporting countries use differential export taxes to discourage exports of basic products (such as grains or oilseeds); they force exporters to process the product domestically (into flour or oil and meal, for example) and export the value-added product.

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